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IN THE

Supreme Court of the United States

OCTOBER TERM, 1949

No. 220

In the Matter

of

LONG ISLAND LIGHTING COMPANY
QUEENS BOROUGH GAS AND ELECTRIC COMPANY
NASSAU & SUFFOLK LIGHTING COMPANY

COMMON STOCKHOLDERS COMMITTEE OF
LONG ISLAND LIGHTING COMPANY,
Petitioners,

against

SECURITIES AND EXCHANGE COMMISSION,
LONG ISLAND LIGHTING COMPANY,
QUEENS BOROUGH GAS AND ELECTRIC COMPANY,
NASSAU & SUFFOLK LIGHTING COMPANY,
Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT, AND BRIEF IN SUPPORT THEREOF

HAROLD G. ARON,
LYNNE A. WARREN,
CHARLES B. MCGRODDY, JR.,
Attorneys for Common Stockholders' Committee,
39 Broadway,
New York 6, N. Y.

Dated: July 24, 1950.

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Respondents.

PETITION FOR WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

To the Honorable the Chief Justice, and the Associate Justices of the Supreme Court of the United States:

J. Donald Halsted, E. M. Nichols and B. F. Grizzle as a protective committee for the holders of the Common

Stock of Long Island Lighting Company respectfully pray that a writ of certiorari issue to review the decision and judgment of the United States Court of Appeals for the Second Circuit, affirming an order of the United States District Court for the Eastern District of New York approving, and enforcing a plan of reorganization of Long Island Lighting Company and its subsidiaries.

Opinions Below

The opinion of the District Court dated February 10, 1950, is printed in this Record at pages 363-398. (*In re Long Island Lighting Co.*, 89 F. Supp. 513, 1950.) The opinions of the Court of Appeals for the Second Circuit dated June 1, 1950 and July 5, 1950 (both unreported) are attached to the printed Record as an addition (Record, pp. 860, 936).

A certified transcript of the Record before the Court of Appeals and the proceedings in said Court, is presented herewith pursuant to Rule 38 of this Court.

Jurisdiction

This application is made under Section 1254 of the Judicial Code (28 U.S.C.A. 1254).

The jurisdiction of this Court is invoked under Section 25 of the Public Utility Holding Company Act, 49 Stat. 834, 15 U.S.C.A. §79.

Statutes Involved

Public Utility Holding Company Act of 1935, 49 Stat. 838 (15 U.S.C.A. Sect. 79(a) *et seq.*) §§1, 3, 11 and 12.

Statement

Petitioners are a duly authorized Protective Committee for the holders of common stock of Long Island Lighting Company (hereinafter called "Long Island"), a public

utility holding and operating corporation organized under the laws of the State of New York, which, with its subsidiaries, Queens Borough Gas & Electric Company and Nassau and Suffolk Lighting Company, manufactures and sells electric power and gas to customers within certain counties of the State of New York located on Long Island. (Record, pp. 319, 320.)

On May 21, 1948 petitioners filed with the Securities & Exchange Commission (hereinafter called "the Commission") a declaration pursuant to Rule U-62 of the Commission seeking leave to solicit authorizations to represent Long Island's common stockholders in proceedings under Section 11 of the Public Utility Holding Company Act of 1935 for the reorganization of Long Island and its subsidiaries, which had been pending since November 9, 1945. The declaration was permitted to become effective on June 10, 1948.

Long Island owns all of the common stock of Queens Borough Gas & Electric Company (hereinafter called "Queens"), and Queens owns all of the common stock of Nassau and Suffolk Lighting Company (hereinafter called "Nassau").

As of March 31, 1949, Long Island's capitalization was as follows:

First Mortgage Bonds	$42,035,000
Sinking Fund Debentures	5,974,000
Notes payable to banks	10,000,000
7% cumulative preferred stock, $100 par	7,475,000
6% preferred stock, $100 par	17,905,000
Common Stock ($, stated value)	3,000,000

(Record, p. 155)

One of the issues on this application is whether the 6% and 7% preferred stock were duly and effectively reduced by 40% of their par value prior to the attainment by the Commission of jurisdiction over Long Island.

Prior to April 21, 1945, Long Island was not under the jurisdiction of the Commission; it and each of its subsidiary companies had received an exemption. On December 16, 1944, Long Island filed in the office of the Secretary of the State of New York, with the approval of the Public Service Commission of the State of New York a certificate of reduction of capital to revise the rights and privileges of its stockholders. Certain journal entries were to be made in the books, as ordered by the state commission, and the par value of the outstanding 253,800 shares of preferred stock was to be reduced from $100 to $60 per share. The accumulated dividends as of June 30, 1944 were to remain unaffected. The outstanding 3,000,000 shares of common stock were to be cancelled and in lieu of outstanding stock the company was to issue 503,800 shares of new common stock to the preferred and common stockholders on the basis of one share of new common stock for each share of preferred stock and each 12 shares of common stock. No dividends on the common stock were to be paid until all preferred stock arrearages had been met, and the unearned surplus arising from the reduction in capital and the elimination of paid-in premiums together with existing unearned and earned surplus at June 30, 1940 was to be used to increase the depreciation reserve by $6,000,000 and to provide $4,979,320 as a "special reserve for depreciation" and for loss in value of investments. Almost simultaneously with the filing of the plan, the Commission brought a proceeding in the Eastern District of New York to enjoin any further action, pending an effort by the Commission to cancel the exemption theretofore granted Long Island and its subsidiaries (Record, pp. 368-9).

Notwithstanding the 1944 recapitalization, a new plan of reorganization and various amendments were filed and

hearings had before the Commission. That plan proposed to give to the holders of the 3,000,000 shares of common stock of Long Island outstanding before the 1944 Recapitalization, 35¢ per share, in cash, payable out of future profits, and thus completely to terminate their interests. That plan was based, among other things, upon the admission of the Company and its subsidiaries that there was a deficiency of over $10,000,000 in their depreciation reserves, as found by a report of an engineer of the New York Public Service Commission, but never determined by order (Record, pp. 174, 175).

On October 28, 1948, petitioners filed another declaration with the Commission seeking leave to solicit voluntary contributions of 5¢ per share from the common stockholders, to finance their defense before the Commission, before the New York Public Service Commission, and to provide for other contemplated litigation. This application was denied by the Commission, and its denial was complained of to the District Court as having constituted an undue hindrance upon the defense, a contention which the District Court failed to uphold (Record, pp. 376, 377).

An independent petition is being filed asking this Court to review the order of the United States Court of Appeals for the District of Columbia affirming the order of the Commission imposing this restriction on petitioners.

Upon final argument before the Commission, counsel for Long Island announced that it was no longer intended to increase the reserve for depreciation of the proposed consolidated Corporation by $10,263,969, but to place that amount in an account designated "unearned surplus—special" (Record, p. 289). Petitioners then moved before the Commission to reopen the record to either strike or amend all exhibits based upon the existence of the former alleged $10,263,969, deficiency in depreciation reserves, and

to strike, or recall for further cross examination all witnesses whose testimony was based on the assumption that depreciation reserves were deficient by said sum (Record, pp. 289, 290). The Commission denied this motion (Record, p. 290).

The hearings before the Commission ended in May 1949 and on November 2, 1949, it issued its Findings and Opinion (Record, p. 145) determining that it would approve the plan if certain amendments thereto were made. One of these amendments changed the participation of holders of Long Island common from $.35 per share in cash out of future profits to 5.7% of the proposed new common stock of the proposed consolidated corporation (Record, p. 285).

Other changes were required which are irrelevant to this application.

In its Findings and Opinion, the Commission failed to determine whether or not the 1944 recapitalization was effective, with the result that it is impossible to determine whether the allocation of securities made by the Commission is based upon preferred stock having a par value of $4,485,000 for the 7% and $10,743,000 for the 6%, or $7,475,000 for the 7% and $17,905,000 for the 6% (Record, p. 379), and whether its allocation is based upon preferred dividend arrearages have been accruing since 1945 at the rate of $1,597,550 or at the rate of $958,530 (Record, p. 233).

It also estimated foreseeable net income of $2,815,000 annually for Long Island (Record, p. 209, table XII) stating that such income is approximately 6% on the rate base existing on March 31, 1949, adjusted to reflect an alleged depreciation in deficiency reserves of over $10,000,000 (Record, pp. 207, 208). This is the same item

regarding which Long Island made a last minute change and denied cross examination regarding the change.

The Plan was promptly amended as required, and then approved by the Commission, which applied to the United States District Court for the Eastern District of New York for an order approving and confirming the plan as amended. After a hearing, that Court rendered a decision approving the plan (Record, p. 363) and the Committee appealed to the United States Court of Appeals for the Second Circuit.

After argument of the appeal, on June 1, 1950, the Court of Appeals rendered a decision (Record, p. 860) remanding the plan to the Commission because of the Commission's failure to take into account, in the allocation of new securities among the old security holders, an item of $250,000 of annual savings which would accrue through the consolidation of Long Island with its subsidiaries pursuant to the plan, and its failure, to explain why it did not take this item into account.

On June 6, 1950 the Committee's counsel received notice of a motion made by Long Island before the Commission and granted by the Commission on June 5, 1950 "to adopt an expeditious procedure" and on June 6, 1950, notwithstanding the fact that the proceeding was still pending before the Court of Appeals, the Commission, without notice or hearing, issued its Supplemental Findings and Opinion (Record, p. 870) explaining its treatment of the $250,000.00 item of future savings.

On June 6, 1950 the Commission filed a motion with the Court of Appeals requesting that Court to modify its opinion and withdraw its direction to remand, and to affirm the order of the District Court approving the plan (Record, p. 918). On July 5, 1950, the Court of Appeals granted

this motion and affirmed the order of the District Court approving the plan (Record, p. 938).

By stipulation the parties have agreed that the plan of reorganization will not be consummated until determination of this application (Record, p. 406).

Questions Presented

1. May the Commission disregard and fail to determine the effect of a voluntary recapitalization of a utility holding and operating company which, at the time of such recapitalization, possesses an exemption from the provisions of the Act under Section 3(a) thereof, and which recapitalization is effected under State law, upon the affirmative vote of more than 66⅔% of all of the stockholders affected, and with the consent of the State Public Service Commission.

2. Is an estimate of foreseeable earnings sound, if it results in income of approximately 6% of the net original cost of the electric, gas and apportioned utility plant including construction work in progress, and other applicable items, as of March 31, 1949, when the system concerned is increasing its rate base by expenditure for construction amounting to $15,400,000 for the period January 1, 1949-December 31, 1949, which sum amounts to approximately 15% of the rate base on March 31, 1949, and when the actual income for the calendar year ending December 31, 1949 substantially exceeds the Commission's estimate.

3. Is an estimate of foreseeable income sound which is based upon the existence of an alleged deficiency in depreciation reserves of more than $10,000,000 which is controverted.

4. Has a fair trial been had when a stockholders' protective committee has been refused per-

mission to solicit voluntary contributions to pay its expenses and the expenses of and a retainer to its counsel, and to employ experts, and has been refused the right of cross examination, when, after the record was closed, the company determined no longer to treat its depreciation reserves as deficient in the sum of over $10,000,000.

5. Has the Commission jurisdiction over the reorganization of a utility holding and operating company and its subsidiaries, all of which are organized, located and operating within one state, but which have security holders in many states.

Reasons Relied on for Issuance of Writ

Summary

This case presents:

(1) A novel issue of conflicting state and Federal jurisdiction in that the Courts below have held that the Commission may disregard a valid voluntary recapitalization effected by Long Island while it was exempt from Commission jurisdiction.

(2) The issue of the extent to which the Commission's expert guess of potential income may disregard actual income, and actual and proposed increases of rate base.

(3) The novel issue of the power of the Commission to restrict freedom of communication between stockholders and their duly authorized representatives, necessary to the stockholders' defense, and the Commission's power completely to deny any cross examination regarding a radical change in the proposed balance sheet of the reorganized corporation, made without prior notice, after the record is closed.

(4) A constitutional question.

(1) The first question above presented raises issues of conflicting state and Federal jurisdiction, for the Commission has disregarded legal voluntary recapitalization of a public utility holding and operating corporation, located and operating within a single state, exempt from the jurisdiction of the Commission at the time the recapitalization was effected, which recapitalization was effected by vote of more than 66⅔% of all the stockholders affected.

There is no statute, no rule of the Commission, and no case which authorizes it to disregard a voluntary recapitalization effected by the stockholders at a time when the Commission concededly had no jurisdiction over the corporation. By disregarding such recapitalization, the Commission has invaded stockholders' rights under state law and unlawfully impaired the obligation of the contracts arising as a result of that recapitalization.

This newly assumed power of the Commission is a threat to the contract rights of all stockholders of other utility corporations now outside the jurisdiction of the Commission.

(2) The second question presents the doctrine of the infallibility of the administrative "guess" with respect to future earnings. The Courts below have refused to give effect to a comparison of that guess with actual earnings for the annual period during which the "guess" was made, and we believe that this Court should lay down a rule of law requiring that the "guess" must at least square with historical economic facts established after the "guess" date, and prior to any Court approval.

(3) An important question of general interest in administrative law, both novel and unprecedented, is presented by the restriction which the Commission placed upon petitioners, preventing them from raising funds by soliciting voluntary contributions, and thus depriving them of serv-

ices of engineers and accountants which were required. This Court should determine whether such a radical restriction affords a fair trial, for the power to prevent litigants from raising funds for their defense is the power to destroy the right of defense.

A similar question of fair trial is presented by the Commission's refusal to reopen the record for the further cross-examination when Long Island announced at the oral argument before the Commission that it no longer intended

> "as formerly proposed to increase the reserves for depreciation of the Consolidated Corporation by $10,263,969., but to place that amount in an account designated 'unearned surplus—special' to be available for transfer to reserves for depreciation or for other charges which may be approved by appropriate regulatory authorities." (Record, p. 289)

This last minute change indicated clearly that Long Island had finally become impressed by petitioners' contention that the alleged deficiency was really not as great as asserted, and that the smaller the deficiency, the greater the actual rate base, and thus the greater potential earnings were.

The Commission's refusal to permit inquiry into this grave change constituted refusal of a fair trial, and presents a proper case for review by this court of so radical an exercise of claimed administrative discretion in a field of procedure, and not in the field of drawing expert conclusions from technical data.

(4) The Constitutional question presented is whether under the Act, the Commission has jurisdiction over the reorganization of a solvent public utility holding and operating corporation and its subsidiaries, all of which exist, are located and operate only within one state, but

which has security holders in many states. This Court has never determined that mere inter-state distribution of securities is sufficient to permit the Federal Government completely to withdraw from state control the reorganization and recapitalization of a public utility holding and operating corporation wholly intra-state in nature and operation.

Prayer

Wherefore, for the reasons stated above and more fully set out in the annexed brief, petitioners respectfully pray that a writ of certiorari be issued out of and under the seal of this Honorable Court directed to the United States Court of Appeals for the Second Circuit, commanding that Court (or if its mandate has gone down to the United States District Court for the Eastern District of New York commanding that Court) to certify and send to this Court for its review and determination, on a day certain to be therein named, a full and complete transcript of its record and proceedings in the case in said United States Court of Appeals for the Second Circuit, and that the decision of the United States Court of Appeals for the Second Circuit affirming the order of the United States District Court for the Eastern District of New York, be reversed by this Honorable Court, and that petitioners have such other and further relief in the premises as to this Honorable Court may seem just and proper.

Dated: July 24, 1950.

Respectfully submitted,

HAROLD G. ARON,
LYNNE A. WARREN,
CHARLES B. MCGRODDY, JR.,
Attorneys for Common Stockholders' Committee.

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Respondents.

BRIEF IN SUPPORT OF PETITION FOR WRIT OF CERTIORARI

POINT I

This Court should review the erroneous judicial approval given below to the Commission's disregard of the 1944 recapitalization, approved by more than 2/3 of each class of stockholders affected.

As the petition shows (p. 4, *supra*), while Long Island still held an exemption from the Act, more than ⅔ of the

holders of its common, and more than ⅔ of the holders of its preferred stock, voted in favor of amending its certificate of incorporation to accomplish the following results:

> 1. To reduce the par value of its outstanding preferred stock by 40%.
>
> 2. To compensate the preferred holders by giving each of them one share of new common, which would give them, as a class, voting control, since they would hold more than 50% of all of the new common stock (prior thereto they had no voting power in the election of directors).
>
> 3. To change the previously outstanding 3,000,000 shares of common stock into 250,000 shares of new common stock, giving each old stockholder one share of new stock for each twelve shares of old.

On December 16, 1944, a Certificate of Reduction of Capital, duly approved by the New York Public Service Commission, was duly filed with the Secretary of State of the State of New York, to accomplish these changes (Record, pp. 368-9).

Under the law of the State of New York, the changes effected by the Certificate became effective upon the filing, for Sect. 8 of the New York General Corporation Law provides in part as follows:

> "Immediately upon the filing of a certificate of incorporation in the department of state, the existence of the corporation created thereby shall be deemed to begin, and immediately upon such filing of any certificate amendatory of or supplemental to any certificate of incorporation, such certificate of incorporation shall be deemed to be amended or supplemented in accordance with the provisions thereof. As amended, L. 1931, c. 655, §1; L. 1940, c. 261, eff. April 8, 1940."

Thus under the New York statute, on December 17, 1944, Long Island had outstanding not $7,475,000 par value of 7% preferred stock, but only 60% thereof; not $17,905,000 par value of 6% preferred, but only 60% thereof, making a total reduction of over $10,000,000 of par value in the preferred (Record, p. 329).

Moreover, under the law of New York, which at the time was the only applicable law, Long Island being then exempt from the Act, cumulative dividends, which, prior to the recapitalization, had accrued on the preferred at the rate of 1,597,550 annually, after the recapitalization were reduced to $958,530 annually (Record, pp. 233, 234).

In its original Findings and Opinion, the Commission found (Record, p. 233) that if its "estimate of reasonably prospective net income for Long Island of $2,815,000 a year" could be applied towards the liquidation of arrears in preferred dividends, giving no effect to the 1944 recapitalization, the arrears would be paid off in approximately 14½ years. On the other hand, if the 1944 recapitalization were deemed effective, and the same procedure followed it would take only 7.8 years to achieve the same result (Record, p. 234).

These were the only mathematical or logical processes used by the Commission to allocate the new stock between the preferred and common holders of Long Island. From them it appears that if the 1944 recapitalization were effective, the old common would be worth approximately twice as much as if it were not.

Yet no determination is made of the effectiveness, so that it cannot be determined which base was used by the Commission in allocating nor can it even be determined whether some compromise base was taken.

The District Court in approving the plan wrote as follows:

> "Be that as it may, the assumption that the Federal commission was bound to answer the legal question is completely groundless. What the federal commission in fact did was to treat the Long Island security holders as participants in a proceeding in equity. The 1944 plan had been denounced as unfair and inequitable both by the state commission and the federal commission. In realty, that plan had and has no present vitality or importance, and if it had, the federal commission was obviously free to refuse to define, as it did, the technical legal rights flowing from that plan. The commission could simply have refused to enforce such 'rights', if any, because of want of equity." (Record, p. 394)

The Court of Appeals wrote:

> "On commencement of the revocation proceeding in November 1944 the jurisdiction of the Commission over Long Island attached. Any change in its capitalization thereafter was subject to review by the Commission, and, even if effective, under state law, could be disregarded by the Commission in a plan filed under section 11(e), since what is 'fair and equitable' is a federal question." (Record, p. 866)

The District Court cites neither statute, case or rule to sustain its holding that the Commission properly disregarded the 1944 recapitalization.

The District Court and the Court of Appeals disagree upon when the Commission's jurisdiction over Long Island arose: The District Court holding that

> "Prior to April 21, 1945, Long Island was not under the jurisdiction of the commission." (Record, p. 368)

and the Court of Appeals holding that the commission's jurisdiction attached in November, 1944, some five months

before any revocation of its exemption, or its voluntary registration as a holding company under the Act. In this connection, we must note that this very Court of Appeals wrote of this same recapitalization:

> "The appellee promptly filed its certificate of recapitalization together with the order of approval, in the office of the Secretary of the State of New York, in pursuance of the Stock Corporation Law. The plan became effective upon such filing (General Corporation Law, Consol, Laws c. 23, §8), the rights of the stockholders under the corporate structure thereupon came to an end, trading in the old stock ceased on the New York Curb Exchange on December 16, and trading in the new stock commenced on December 18. On December 19 the appellee was ordered to show cause why a preliminary and permanent injunction should not be entered restraining it from carrying out the recapitalization plan, and concurrently the temporary restraining order issued. Because of it, and the order out of this court compelling further restraint pending hearing on appeal, the appellee says it is now a corporation without stockholders, and unable to do any of the things which, by state law, require the approval of stockholders." (Securities and Exchange Commission *v.* Long Island Lighting Co., 148 Fed. 2nd Cir., 1945, 252, 253, 254)

In that case, the commission unsuccessfully sought to enjoin Long Island from carrying out the 1944 Recapitalization. This Court granted certiorari (324 U. S. 837) when the Court of Appeals affirmed the District Court's refusal to grant an injunction, but upon voluntary registration by Long Island under the Act, the cause became moot, and at 325 U. S. 833 this Court vacated the judgment of the Court of Appeals and remanded the case to the District Court with directions to dismiss the complaint.

The same Court which held in February 1945 that Long Island was then outside the commission's jurisdiction, is holding now that on December 16, 1944 it was within such jurisdiction, although concededly then holding an exemption.

Unless the effect of the 1944 Recapitalization is determined, the par value of the preferred stock, and the amount of the arrearages thereon are unknown, and there is no starting place for an allocation of securities among the stockholders.

Here is a clear and unprecedented clash of Federal and State jurisdiction, of wide scope and general importance calling for final determination by this Court.

POINT II

When the Commission's estimate of foreseeable income, allegedly based upon future availability of natural gas which will effect very large economies, is lower in amount than the company's actual earnings for the period before the natural gas becomes available, it must be revised to be consistent with historical facts.

The Commission estimated foreseeable income for Long Island of $2,815,000 (Record, p. 209). In making this estimate the commission asserts it

> "gives effect to lower earnings to be realized prior to the advent of natural gas and improved earnings thereafter, * * *." (Record, p. 209)

The actual net income of Long Island for the calendar year ending December 31, 1949, during all of which period no natural gas was available, amounted to $3,048,685

(Record, p. 716) or more than 8.2% in excess of the commission's estimate of what that income would be after natural gas became available, and the Company itself has estimated its annual savings from natural gas at from $2,600,000 to $3,100,000 per annum (Record, p. 837).

Thus the expiration of the period March 31, 1949 to December 31, 1949 made facts available which contradicted the rationale of the Commission's estimate, for the Company's income for that period, without natural gas, was 8.2% greater than the Commission's estimate of its income when natural gas would become available. And this, in turn, is without giving effect to estimated savings of $250,000 resulting from the consolidation (Record, p. 210) and without giving effect to a rate base at the end of 1949 which exceeded the March 31, 1949 rate base by many millions.

The Courts below have not even discussed this discrepancy between estimate and fact, but have treated the case as though petitioners were merely contending that the estimate must closely approximate dollar results.

The Commission estimated foreseeable net income

> "without giving effect to any savings from consolidation which are estimated by the applicant companies at approximately $250,000. a year after provision for Federal income taxes." (Record, p. 210)

Later in its Findings and Opinion the Commission wrote

> "It should be noted that to the extent the Consolidated Corporation is able to effect economies and savings as a result of consolidation, the amounts of net income applicable to the foregoing would, of course, be increased proportionately." (Record, p. 229)

On appeal, the Court of Appeals in its first opinion remanded the case back to the Commission stating with regard to this consolidation saving:

> "We can see no reason why, if this is a legitimate item of future income, it cannot be allocated first between Long Island's share between preferred and common." (Record, p. 868)

and again the Court of Appeals wrote at page :

> "If the Commission completely disregarded this $250,000. item, we think it was an error in so doing. We are, however, not entirely clear that it did so."

The Court then remanded the case to the Commission stating that the Commission should give its reasons for excluding this item, if it did, or if it took the item into account "in some unexplained manner" (Record, p. 868) it should so state.

The companies then made motion before the Commission, giving no notice to petitioners, asking the Commission "to expedite the proceedings." The motion was made on June 5, on June 6 the Commission came out with its Supplemental Findings and Opinion in which it stated of the consolidation savings that

> "we did not ignore the testimony concerning them. As we note below, we deliberately excluded these savings from certain mathematical computations which were a step in our analysis." (Record, p. 870)

Then the Commission says that

> "the consolidation savings, if any, were not directly used as a measure of a fair allocation of the new stock except for a minor qualification noted below." (Record, p. 870)

The Commission offers no defense of its refusal or failure to use this item as part of the income, which could be applied to pay off preferred arrears. Its attempted excuse that the Public Service Commission would not permit the company to keep this income is predicated, of course, as we have shown, on a rate base a year and a half old which now is many millions of dollars larger than it was.

Then the Commission made its motion asking the Court of Appeals to modify its former opinion and affirm the order of the District Court. The Court of Appeals granted this motion on July 5, 1950 (Record, p. 892). The Court held that the Commission had made

> "at least a reasonable guess about the expectable influence of the factor." (Record, p. 938)

It explained the Supplemental Opinion as stating that the Commission

> "did not ignore the item of consolidated savings but disregarded them for two reasons, first because it was not clear how far, if at all, the Public Service Commission would allow the new company to profit by consolidation savings, and second that the Commission had taken it into account by reckoning that in bad years the new company might not be able without it to earn the full amount of rates allowed."

The record is devoid of evidence of what the Public Service Commission would do regarding the consolidation savings.

We are unable to appreciate the distinction between ignoring the item, and disregarding it.

To say the least, an issue is presented of the propriety of an appellate court deciding an appeal on the basis of a record partly made after it had written an opin-

ion determining the appeal. It is clear that the reviewing power of this court is vitally needed to determine the appropriate limits of administrative estimates, and judicial procedure in reviewing it.

POINT III

The restrictions placed by the Commission on the defense of the common stockholders resulted in an unfair trial, and call for this Court's construction of the scope of administrative power to limit defense.

The petitioners were prohibited by the Commission from raising a defense fund to pay expenses (Record, p. 376). The District Court wrote:

> "I find nothing in the record showing that the representation of the common stock before the federal commission was stifled, or was in any way weakened by the commission's action." (Record, pp. 376-377)

This holding the Court of Appeals affirmed (Record, p. 860) with the statement that

> "The Committee's claim of prejudice is chiefly based on the contention that lack of funds deprived it of the opportunity to submit evidence of reproduction costs." (Record, p. 863)

This was not petitioners' chief complaint. Without funds, they had no accounting services whatsoever, and practically no engineering assistance. This was, and is, their chief complaint.

Later, discussing our complaint about the excessive depreciation reserves, the Court of Appeals wrote:

> "Considering that the state Commission had tentatively found a deficiency of $10,263,969 in the re-

> serves for depreciation and that no one had proved the figure wrong, we see no impropriety in the Commission's acceptance of this figure without further independent inquiry in arriving at a rate base and rate of return for use in checking the accuracy of its estimate of future net income." (Record, p. 868)

Since the petitioners had, and were prohibited from raising funds to employ engineers or accountants, and were prevented from cross examining when the company made its last minute change on this item, it is simple to see why

> "no one had proved the figure wrong, * * *"

The second restriction on their defense was the Commission's refusal to reopen the record and permit cross examination after the Company had announced that the balance sheet of the reorganized company would be changed by translating this item of over $10,000,000 from reserves for depreciation to unearned surplus special (Record, pp. 289-290).

The District Court did not even discuss this restriction of defense, although it discussed the item (Record, pp. 383-386).

The Court of Appeals thought the denial of the motion to reopen was for

> "reasons stated by the Commission which we think adequate." (Record, p. 867)

The only reason given by the Commission for stifling the inquiry is found at page 290 of the Record, and is as follows:

> "We do not believe the record should be opened. As noted, we have readily adjusted the submitted ex-

> hibits to reflect the proposed change in treatment. This is merely a simple adjustment as to which no testimony is needed. The pattern of regulation by the New York Commission indicates that the designation of the amount of depreciation as set forth on the books would not be conclusive in connection with rates and, as we have already explored the earning power of the companies in the light of this, and other factors, the accounting treatment of this item is not such as to require that the record be opened. The motion, accordingly, will be denied."

Nowhere does Commission or Court discuss the reason for the last minute change by the Company of this item of over $10,000,000 from reserve for depreciation to unearned surplus special.

The status of this item is most important in the determination of foreseeable income, for the Commission tested foreseeable income by applying a percentage rate to rate base (Record, p. 207) and rate base cannot be determined without a determination of this item of alleged deficiency in depreciation reserves.

This Court should review and reverse because of these administrative restrictions on defense.

POINT IV

By its terms the Act does not apply to wholly intrastate holding company systems, and, if applied to them it would be unconstitutional.

We know that this Court denied certiorari, sought by the New York Public Service Commission in *"Public Service Commission of N. Y. et al.* v. *SEC"*, 166 Fed. (2) 784 at 788, cert. den. 1948, 334 U. S. 838, where the Court of Appeals wrote that

> "The constitutional question is too trivial to justify discussion."

In that case, the issue was raised by the NYPSC, and the District Court wrote that it had "grave doubt" as to whether it should pass on the constitutional question because of the rule that none except an injured person has the right to attack on constitutional grounds. (*In re Kings County Lighting Co.*, 72 Fed. Sup. 767.)

Here the question is being raised by security holders whose rights are being modified by the Commission so the right to attack is clear, and the consequent constitutional question is not "trivial" as to them.

The issue here is whether

> (a) The sale of gas or electricity to other persons engaged in interstate commerce,
>
> (b) The use of the mails to make payments to and transmit information to its securityholders,
>
> (c) The use of the mails and perhaps other means of interstate commerce to arrange and pay for supplies purchased from sources without the State,

alone or in combination constitute engaging in interstate commerce, or in activities directly affecting or bordering interstate commerce, sufficient to vest regulatory power over the reorganization of this company in the Commission.

Section 1(a) of the Act recites that "Public-utility holding companies and their subsidiary companies are affected with a national public interest * * *", and Subdivision (b) recites certain evils found among them. Subdivision (c) sets out the policy of the Act designed to end such evils, and provides as follows:

> "When abuses of the character above enumerated become persistent and wide-spread the holding company becomes an agency which, unless regulated, is injurious to investors, consumers, and the general public; and it is hereby declared to be the policy of this title, in accordance with which policy all the provisions of this title shall be interpreted, to meet the problems and eliminate the evils as enumerated in this section, connected with public-utility holding companies *which are engaged in interstate commerce or in activities which directly affect or burden interstate commerce;* * * *." (Emphasis ours.)

In construing the Act, we refer to this Court's admonition in *Kirschbaum* v. *Walling,* 316 U. S. 519, at page 521, where Mr. Justice Frankfurter wrote:

> "We cannot, therefore, indulge in the loose assumption that when Congress adopts a new scheme for federal industrial regulation, it thereby deals with all situations falling within the general mischief which gave rise to the legislation. Such an assumption might be valid where remedy of the mischief is the concern of only a single unitary government. It cannot be accepted where the practicalities of federalism—or, more precisely, the underlying assumptions of our dual form of government and the consequent presuppositions of legislative draftsmanship which are expressive of our history and habits—cut across what might otherwise be the implied range of the legislation."

The Act was not intended to be applied to holding companies if

> "such holding company, and every subsidiary company thereof which is a public-utility company from which such holding company derives, directly or indirectly, any material part of its income, are

> predominantly intrastate in character and carry on their business substantially in a single State in which such holding company and every such subsidiary company thereof are organized;"

for Section 3(a) of the Act directs that the Commission shall exempt such companies from the Act "unless and except in so far as it finds the exemption detrimental to the public interest or the interest of investors or consumers".

This Court has written of this exemption:

> "By making these enumerated interstate transactions unlawful unless the holding company registers with the Commission and by extending Sec. 11(b)(1) to registered holding companies, Congress has effectively applied Sec. 11(b)(1) to those holding companies that are in fact in the stream of interstate activity and that affect commerce in more states than one. Congress has further declared in Sec. 1(c) 15 U.S.C.A. Sec. 79a (c) 4 F.C.A. Title 15 Sec. 79a(c) that all the provisions of the Act thus including Sec. 11(b)(1), shall be interpreted to meet the problems and remove the evils connected with public utility holding companies 'which are engaged in interstate commerce or in activities which directly affect or burden interstate commerce'. Section 11(b)(1) is thus clearly and unmistakably applicable to holding companies engaged in interstate commerce. * * *"
>
> *North American Co.* v. *Securities and Exchange Commission*, 327 U. S. 686, 698-9, 90 L. Ed. 945.

Again, in *American Power & Light Co.* v. *S. E. C.*, 329 U. S. 90, the Court wrote of Sec. 11(b)(2) at page 98:

> "* * * Its impact is likewise limited, by reference to the registration requirements, to those hold-

> ing companies which depend for their very existence upon the constant and systematic use of the mails and the instrumentalities of interstate commerce."

Heretofore the Commission has viewed Long Island and all its subsidiaries as "predominantly intrastate in character", and as "companies which carry on their business substantially in a single state in which such holding company and every such subsidiary company thereof are organized", and thus subject to the Act unless exempted under Section 3(a)(1).

We submit that this viewpoint is patently erroneous, for in fact Long Island and all its subsidiaries are not predominantly, but wholly and completely intrastate in character, and they carry on their business not "substantially" but wholly and completely within the single State in which they are all organized. For that matter, Long Island is not even predominantly a holding company but is predominantly an operating company. It is common knowledge that the Act was needed to regulate those familiar-to-investors holding companies which had no public utility operations, and were thus beyond the reach of State regulatory authorities.

For a company to be predominantly intrastate in character it must have other, *i.e.*, interstate characteristics, which are those over which the intrastate characteristics predominate. It is these other interstate characteristics which we may call the subordinate characteristics which give rise to jurisdiction under the Act and require the exemption. These other characteristics are absent in this case, and being absent, prevent jurisdiction from arising, and make exemption unnecessary.

The record shows that neither Long Island or its subsidiaries is engaged in interstate commerce.

It remains only to be shown that the System is not engaged in activities "which directly affect or burden interstate commerce." (Sec. 1(c) of the Act.)

Our search, then, must be for activities of the System which directly change for the worse, or burden, interstate commerce engaged in by others, for, as we have shown, it is engaged in none itself.

The System has proposed a recapitalization, approved by more than two-thirds of its stockholders, and embodied in the 1944 Recapitalization. This is the only conceivable activity shown by the record upon which the contention of engaging in an activity "directly affecting or burdening interstate commerce" can be based.

If it be contended that an unfair, although perfectly democratic and legal reorganization of an entity like this System, not engaged in interstate commerce, effected under State Law and with the consent of appropriate State officials, can or does directly change for the worse or burden interstate commerce, then all local corporate law is of only historical interest, for Congress then may, under the commerce clause, evict all the States from the field of the law of corporate recapitalization, under the plea that the sole standard of fairness for securities which are traded in interstate commerce is a Federal standard.

We know of no case or statute which contains even an intimation of this principle, so destructive of our system of dual sovereignty.

CONCLUSION

As a study of the decisions of the Commission, the District Court and the Court of Appeals discloses, none of them has answered petitioners' contentions. That study discloses that these contentions raise novel questions of wide general interest relating to the accommodation of our

state and Federal systems, to administrative and constitutional law, to civil rights in the economic field. The questions raised can only be settled by this Court, whose function it is, ultimately to determine such issues and establish the final criteria for colliding Federal and state jurisdiction, for administrative procedure, and for the exercise of Constitutional rights.

A writ of certiorari should be granted.

Respectfully submitted,

HAROLD G. ARON,
LYNNE A. WARREN,
CHARLES B. MCGRODDY, JR.,
Attorneys for Common Stockholders' Committee.

Dated: July 24, 1950.

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In the Supreme Court of the United States

OCTOBER TERM, 1950

No. 220

COMMON STOCKHOLDERS COMMITTEE OF LONG ISLAND LIGHTING COMPANY,
Petitioners

v.

SECURITIES AND EXCHANGE COMMISSION, LONG ISLAND LIGHTING COMPANY, QUEENS BOROUGH GAS AND ELECTRIC COMPANY, NASSAU & SUFFOLK LIGHTING COMPANY.

No. 221

LOUIS W. GORDON, COMMON STOCKHOLDER OF LONG ISLAND LIGHTING COMPANY,
Petitioner

v.

SECURITIES AND EXCHANGE COMMISSION, LONG ISLAND LIGHTING COMPANY, QUEENS BOROUGH GAS AND ELECTRIC COMPANY, NASSAU & SUFFOLK LIGHTING COMPANY.

On Petitions for Writs of Certiorari to the United States Court of Appeals for the Second Circuit

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No. 249

J. DONALD HALSTED, E. M. NICHOLS AND B. F. GRIZZLE AS A PROTECTIVE COMMITTEE FOR THE HOLDERS OF THE COMMON STOCK OF LONG ISLAND LIGHTING COMPANY,
Petitioners

v.

SECURITIES AND EXCHANGE COMMISSION

On a Petition for Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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BRIEF FOR SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinions of the Court of Appeals for the Second Circuit (R. 860-869, 936-938) are not yet reported. The opinion of the District Court (R. 363-398) is reported in 89 F. Supp. 513. The findings and opinion of the Commission, dated November 2, 1949, its order dated November 16, 1949, and its supplemental findings and opinion, dated June 5, 1950, have not yet been officially reported but are set forth in the Commission's Holding Company Act Releases Nos. 9473, 9510, 9900 (R. 145-315, 340-346, 883-891).

The opinion of the Court of Appeals for the District of Columbia Circuit (2R 108-121)[1] is not yet reported. The findings, opinion and order of the Commission, dated March 31, 1949, have not yet been officially reported but are set forth in the Commission's Holding Company Act Release No. 8965 (2R 97-107).

JURISDICTION

The judgment of the Court of Appeals for the Second Circuit was entered on July 5, 1950 (R. 938), and the petitions for writs of certiorari were filed on July 26, 1950. The judgment of the Court of Appeals for the District of Columbia Circuit was entered on April 24, 1950 (2R. 122). On July 21, 1950, Mr. Justice Burton extended the time for filing this petition to and including August 22,

[1] The symbol "2R" will be used to designate the Record in No. 249.

1950 (2R. 130-131), and the petition was filed on August 14, 1950. The jurisdiction of this Court is invoked under 28 U. S. C. 1254 and Sections 24 and 25 of the Public Utility Holding Company Act of 1935 (15 U. S. C. 79x, 79y).

STATUTE INVOLVED

The pertinent provisions of the Public Utility Holding Company Act are set forth as an Appendix hereto, *infra* pp. 37-40.

QUESTIONS PRESENTED

1. Are the reorganization provisions of Section 11 of the Public Utility Holding Company Act unconstitutional as applied to a predominantly intrastate holding company whose exemption from the Act was revoked on the basis of administrative findings under the statute that complexities of the system adversely affected interstate commerce to the detriment of the public interest and the interest of investors?

2. Did the courts below err in holding that there was a fair hearing and that there was a rational basis in law and in fact for the Commission's application of the "fair and equitable" standard of Section 11(e) to the instant plan?

3. Does the Commission's power under Section 12(e) of the Act to regulate solicitation of "any proxy, power of attorney, consent, or authorization regarding any security of a registered holding company" justify the denial of permission to a committee to solicit cash contributions?

STATEMENT

Long Island Lighting Company (Long Island) is a registered holding company. The Commission has approved a plan of reorganization under Section 11(e) of the Holding Company Act which provides for the consolidation of Long Island with its principal subsidiary companies, Queens Borough Gas and Electric Company (Queens) and Nassau & Suffolk Lighting Company (Nassau), assumption by the Consolidated Corporation of the outstanding indebtedness of each of the three companies and the exchange of common stock of the consolidated company for the preferred stocks, including dividend arrears thereon, of the three companies, as well as an exchange of common stock of the consolidated company for the common stock of Long Island. The allocation of common stock of the consolidated company to the preferred stockholders of the subsidiaries is not in controversy.

Petitioners in Nos. 220 and 249 are a committee for common stockholders of Long Island. Petitioner in No. 221, a common stockholder of Long Island, did not participate at all in the administrative hearings on the Plan, having acquired his stock after the hearing was closed. While the enforcement proceedings were pending in the District Court, he filed a petition for rehearing (R. 766), which the Commission denied (R. 821).

Petitioners complain that the Plan allocates an inadequate proportion of the new common stock to the common stockholders of Long Island in re-

lation to that issued to Long Island's preferred stockholders. They also raise a variety of procedural and jurisdictional questions. The committee has filed a separate petition, No. 249, to review a decision of the Court of Appeals for the District of Columbia Circuit affirming an order of the Commission, issued in the course of the plan proceedings, denying the committee authority to solicit funds from stockholders. We believe that a single statement in response to all three petitions will serve the convenience of the Court.

Background of the Plan Proceedings[2]

Long Island and its subsidiaries are each incorporated in New York and are engaged in distributing gas and electricity exclusively in that state. By order, dated March 27, 1936, the Commission granted Long Island an exemption from the Act pursuant to Section 3(a)(1). See *Long Island Lighting Co.*, 1 SEC 345. That order was by its terms, and by Section 3(c) of the Act, expressly made revocable whenever the Commission should find "that the circumstances which gave rise to the issuance of such order no longer exist."

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[2] This background is pertinent primarily to the committee's contention that the Commission did not have jurisdiction to approve a plan for Long Island or to otherwise regulate it under the Act, and also to the contention that the Commission and the courts below erred in not treating the claims of Long Island's preferred stockholders as diminished and those of its common stockholders as enhanced as a result of an earlier consolidation plan which Long Island's management abandoned after litigation with the Commission.

On November 10, 1944, the Commission instituted an administrative proceeding to determine whether Long Island's exemption should be revoked in whole or in part. Some $10,000,000 of arrears had accumulated on Long Island's preferred stocks since the date of the exemption and a committee representing Long Island's preferred stockholders had alleged that Long Island was attempting to consummate an unfair and inequitable plan of recapitalization subject to only such limited safeguards as might be available under state law. Among the issues posed was whether these new circumstances made it in the public interest to subject Long Island to the corporate simplification requirements of Section 11(b)(2), and the "fair and equitable" standards of Section 11(e). The hearing was ordered to convene on December 19, 1944. See *Long Island Lighting Co.,* Holding Company Act Releases Nos. 5406 and 5439.

On December 18, 1944, this Commission was advised that Long Island was about to consummate its plan under New York law without awaiting the outcome of the administrative proceedings. In order to preserve the *status quo* pending a decision in the administrative proceedings the Commission brought suit to enjoin consummation of Long Island's plan. The District Court denied the relief sought. *SEC* v. *Long Island Lighting Co.,* 59 F. Supp. 610 (E.D. N.Y.). The District Court's judgment was affirmed on appeal, 148 F. 2d 252

(C.A. 2) (one judge dissenting),[3] and a writ of certiorari was granted by this Court on March 26, 1945. The *status quo* was preserved in the course of this litigation by a series of temporary stays, including a stay granted by this Court. 324 U.S. 837.

Shortly before the case was to be reached for argument and after the government's brief on the merits was filed, the Commission completed the administrative proceedings and on April 21, 1945, issued its Findings, Opinion and Order. The order modified Long Island's exemption and subjected the Long Island system to various regulatory provisions of the Act, including the registration requirements of Section 5, the corporate simplification provisions of Section 11(b)(2), and the regulatory requirements with respect to proxy solicitations of Section 12(e). See *Long Island Lighting Co.,* Holding Company Act Release No. 5746. Neither Long Island nor any other interested party sought review of that order. Two days later Long Island registered as a holding company under the Act and abandoned further efforts to consummate the earlier plan. This Court was advised of these circumstances, and on April 30, 1945, it vacated the judgment of the court below with directions to dismiss the action because of mootness. 325 U.S. 833.

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[3] The Second Circuit has since repudiated that decision. *West India Fruit & Steamship Co.* v. *Seatrain Lines, Inc.*, 170 F. 2d 775, 779.

The Plan Proceedings

From the time when Long Island registered as a holding company to the present, there has been a continuous effort to bring about the reorganization of Long Island and its subsidiaries in such a way as to reconcile conflicting views of the various interested security holders and their representatives and of the New York and federal regulatory authorities. In the meanwhile dividend arrears have continued to accumulate on the preferred stocks of both parent and subsidiary companies, while growing demands for plant improvement and expansion could be met only by debt financing, including short term bank credit.

In October, 1945, Long Island and its subsidiaries jointly filed a plan under Section 11(e) of the Act. Proceedings on that plan were consolidated with proceedings to prescribe the action required of Long Island and its subsidiaries under Section 11(b)(2) of the Act.[4] See *Long Island Lighting Co.*, Holding Company Act Release No. 6218. The subsequent developments in the consolidated proceedings involved, *inter alia*, the taking of substantial valuation evidence; filing of amendments to the plan to meet public interest objections

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[4] Section 11(b)(2) of the Act, 49 Stat. 821, 15 U. S. C. 79k(b)(2), empowers the Commission to require each registered holding company and each subsidiary thereof to take such steps as the Commission shall find necessary to eliminate undue and unnecessary complexities of the holding-company system and the unfair or inequitable distribution of voting power among the security holders of the system.

voiced by the New York Commission (see 73 P.U.R. (N.S.) 266 (1947) (R. 409)); a separate determination of the Section 11(b)(2) issues by an order, dated August 25, 1948, which held that voting power was unfairly and inequitably distributed among the preferred and common stocks of each of the system companies, in contravention of the standards of Section 11(b)(2), and required a recapitalization of each of the companies on the basis of common stock in lieu of the outstanding preferred and common stocks. *Long Island Lighting Co.,* Holding Company Act Release No. 8449. No review was sought from that order, and the time for such review has long since expired.

On November 2, 1949, the Securities and Exchange Commission issued its Findings and Opinion to the effect that the plan would be approved if it were modified, *inter alia,* to provide for an allocation of stock rather than the proposed cash payment of 35 cents per share to the holders of Long Island common stock. *Long Island Lighting Co.,* Holding Company Act Release No. 9473 (R. 145). On November 10, 1949, the plan was amended in accordance with the Commission's findings (R. 317), and, as amended, was approved by the Commission on November 16, 1949 (R. 340).

The plan, as amended, provides that the Consolidated Corporation will have only one class of stock, namely, common stock consisting of 3,149,696.6

shares. These are to be distributed among the public shareholders of the three companies in exchange for their existing holdings, including dividend arrearages, as follows:

Stocks or Certificates of Deposit Held by Public	NEW COMMON STOCK WITHOUT PAR VALUE Number of Shares Outstanding	No. of Shares Per Share Outstanding	Total No. of Shares	Percent of Common Stock
Long Island				
Pfd.—Series A 7%	74,750	10.4	777,400	24.68%
Series B 6%	179,050	9.2	1,647,260	52.30
Sub-total			2,424,660	76.98%
Common	3,000,000	0.06	180,000	5.71
Sub-total for Long Island			2,604,660	82.69%
Queens—6% Pfd.	66,860	5.42	362,381.2	11.51
Nassau—7% Pfd.	27,262	6.7	182,655.4	5.80
Total			3,149,696.6	100.00%

On February 17, 1950, the District Court entered an order enforcing the plan approved by the Commission (R. 399). The Court of Appeals for the Second Circuit on June 1, 1950, affirmed that decision on all issues except with respect to the item of "consolidation savings," discussed at pages 25-27 below. The Court stated that the Commission's treatment of that matter was not clear and that it could not accept the exclusion of that item "without an adequate explanation of the Commission's reasoning" and ordered a remand on that sole issue (R. 868-869). Upon request of the company, and upon its representations concerning the hardship which might result from further delay, the Commission petitioned the Court of Appeals to withhold its mandate, accept a supplemental opinion of the Commission as a response to the Court's questions, reconsider its decision and affirm the

order of the District Court (R. 880-891). Pursuant to leave of court, petitioners replied to the petition (R. 892-935). The Court of Appeals stated that its doubts had been satisfied by the supplemental opinion, and on July 5, 1950, it affirmed the order of the District Court in all respects (R. 936-938).

The Committee's Proposed Solicitation of Funds

On May 21, 1948, the committee filed a declaration pursuant to Section 12(e) of the Act and Rule U-62 adopted thereunder, regarding its proposed solicitation of proxies or authorizations to represent the common stockholders of Long Island in the pending reorganization of Long Island and its subsidiaries (2R. 11-27). This declaration was subsequently amended in several respects (2R. 28-33), and as amended was permitted to become effective on June 10, 1948 (2R. 33). Among the declared purposes of the committee was to obtain a "speedy recapitalization" and to oppose as inadequate the proposed payment of 35 cents a share to Long Island's common (2R. 20-21). The form of authorization sought by the committee contemplated that the committee would be subject to the supervision of this Commission and that the committee would look to the estate, rather than to those conferring authorization, for its fees and expenses (2R. 26). Solicitation of authorizations commenced shortly thereafter and, according to its statement, the committee has received authorizations from

holders of approximately 800,000 shares of the common stock of Long Island, out of a total of 3,000,000 shares outstanding (2R. 99).

On October 28, 1948, after the committee had presented its direct case in opposition to the plan and when, indeed, the record in the Section 11(e) proceedings was substantially completed, the committee sought authority to solicit funds from the common stockholders of Long Island at the rate of 5 cents per share. The purpose of this solicitation was to secure funds out of which the committee proposed to pay $15,000 in fees to its counsel, approximately $7,500 to its expert witness, and miscellaneous expenses of the committee, including an outstanding bank loan. Any amount remaining would be used to defray the cost of future litigation (2R. 43-45). In its proposed soliciting material the committee stated that application would be made in the Section 11(e) reorganization proceedings for compensation and expenses of the committee and its counsel, and the amounts so received would be used to reimburse the fund to be established by stockholder contributions. Upon receipt of such amounts, the stockholders would be repaid the amount contributed by them. The proposed solicitation material, as originally filed, made no provision for the contingency that the committee and its counsel might receive no compensation or reimbursement for expenses in the reorganization proceedings, or less than the amount expended by the committee out of the solicited funds. However,

in their brief and at the oral argument counsel for the committee stated that the committee, its counsel and its experts would be willing to stipulate that if the amounts finally allowed by the Commission for compensation and expenses should be less than the amounts received from the contributed fund, those receiving such overpayments would repay the amount of the excess (2R. 100-101).

Pursuant to notice (2R. 46-52), a hearing was held with respect to the committee's proposal. Proposed findings and briefs were submitted and oral argument was heard by the Commission on January 5, 1949 (2R. 53-96, 99). On March 31, 1949, the Commission issued its Findings, Opinion and Order. The Commission found that the proposed solicitation was subject to the jurisdiction of the Commission and, for reasons discussed more fully below, denied effectiveness to the proposal on the ground that such solicitation was not in accord with the public interest and the interest of investors (2R. 97-107). A petition to review this order was filed in the Court of Appeals for the District of Columbia which affirmed the Commission's order (2R. 108-121).

ARGUMENT

The numerous points raised by petitioners in their several petitions attempt to bring to this Court virtually every controverted issue which arose in the course of the reorganization proceeding, including issues resolved in prior determina-

tions with respect to the Long Island system. The majority of the issues raised deal with points of procedure or the evaluation of evidence which, whatever their importance to the petitioners in the present proceedings, have no general applicability. Most of them have been decided by prior decisions in this Court and in the Court of Appeals, and there is no conflict of decisions. An analysis of the issues demonstrates the absence of grounds for review in this Court.

1. The committee contends that the Long Island system, being predominantly intrastate in character, is not constitutionally subject to the reorganization provisions of Section 11 of the Holding Company Act (Committee Petition 24-29). The District Court, the Court of Appeals for the Second Circuit, and the Court of Appeals for the District of Columbia Circuit all rejected this argument (R. 373-375, 862; 2 R. 118-120).

Section 3(a)(1) of the Act does not automatically exempt a holding company whose *utility* operations are predominantly intrastate; that exemption is to be granted by the Commission by rule or order "unless and except insofar as it finds the exemption detrimental to the public interest or the interest of investors or consumers." This Court has already upheld the power of the Congress thus to qualify the exemption, stating: "A holding company predominantly local in character may nevertheless engage in activities affecting or burdening

interstate commerce to the detriment of the public interest or the interest of investors and consumers," and cited this Commission's 1945 decision in the *Long Island* case as an apt illustration. See *North American Co.* v. *SEC*, 327 U. S. 686, 699.[5] In modifying Long Island's exemption, the Commission found that the securities of Long Island were widely held among investors in virtually every state and in foreign countries; that the securities of the Long Island system were traded on national securities exchanges by means and facilities of interstate commerce; that upon an examination of the financial aspects of Long Island and its subsidiaries it was evident that control over the system was exercised through a disproportionately small investment; and that the Long Island system exhibited the type of corporate complexities which adversely affected interstate commerce and which Section 11(b)(2) intended to remedy. See *Long Island Lighting Co.*, Holding Company Act Release No. 5746, p. 56. Accordingly, its 1945 order made applicable those provisions of the Act deemed essential for eliminating these complexities. The committee's claim of unconstitutionality and lack of jurisdiction is clearly without substance. *North*

[5] See also Section 1(a), 49 Stat. 803, 15 U. S. C. 79a(a)(1), in which the Congress declared that "Public-utility holding companies and their subsidiary companies are affected with a national public interest in that, among other things, (1) their securities are widely marketed and distributed by means of the mails and instrumentalities of interstate commerce and are sold to a large number of investors in different States."

American Co. v. *SEC*, 327 U.S. 686, 698-700; *American Power & Light Co.* v. *SEC*, 329 U.S. 90, 99-100; *National Labor Relations Board* v. *Jones & Laughlin Steel Corp.*, 301 U.S. 1, 37.

It may be observed that the argument on jurisdiction now advanced by the committee with respect to Long Island was also made in the proceedings for enforcement of a Section 11(e) plan with respect to Kings County Lighting Company, then a subsidiary of Long Island. The Court of Appeals for the Second Circuit sustained the Commission's position, stating: "The constitutional question is too trivial to justify discussion." *Public Service Commission of New York* v. *SEC*, 166 F. 2d 784, 788 (C.A. 2), certiorari denied, 334 U.S. 838. See also decision in instant case (R. 862).

In effect the committee is arguing that there was no warrant for modifying the 1936 order and for requiring Long Island to be reorganized under the Act. This in substance is an attempt to attack collaterally not only that order but also a further order of the Commission dated August 25, 1948, requiring that Long Island and its subsidiaries be reorganized pursuant to Section 11(b)(2). This order was entered in the course of the administrative hearings on the plan and after the committee had become a participant in the proceeding (R. 80-144). However, Section 24(a) of the Act, 49 Stat. 834, 15 U.S.C. § 79x (a), imposes a sixty day limit

for reviewing such orders.[6] It follows, accordingly, that, wholly apart from lack of merit, the committee cannot in proceedings for enforcement of a plan for the purpose of complying with the statutory standards, collaterally attack two prior orders of the Commission as to which direct review is now foreclosed.[7]

2. The committee urges that, "This Court should review the erroneous judicial approval given below to the Commission's disregard of the 1944 recapitalization, approved by more than 2/3 of each class of stockholders affected" (Committee Petition 13). The committee urges that under state law the filing of the certificate of reduction of capital with the Secretary of State of the State of New York accomplished the change of rights specified in the earlier plan. Since this was three days prior to the filing of the Commission's injunction suit

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[6] The last sentence of Section 11(b) expressly provides that "any order made under this subsection shall be subject to judicial review as provided in section 24." Hence, the Commission's Section 11(b)(2) order was subject to review within the prescribed time limitation by a stockholder who is deemed a "person aggrieved" under Section 24(a). *American Power & Light Co.* v. *SEC*, 325 U. S. 385, 388. Also, an order revoking or modifying a company's exemption is subject to review under Section 24(a). See *Philadelphia Co.* v. *SEC*, 82 App. D.C. 335, 164 F. 2d 889, certiorari denied, 333 U. S. 828.

[7] *New York Trust Co.* v. *SEC*, 131 F. 2d 274, 275 (C.A. 2), certiorari denied, 318 U. S. 786; *City Nat. Bank & Trust Co.* v. *SEC*, 134 F. 2d 65, 66 (C.A. 7); *In re Community Gas & Power Co.*, 168 F. 2d 740, 744 (C.A. 3), certiorari denied, 334 U. S. 846.

(although about a month after the institution of the Commission's administrative proceedings), it is contended that the stay of further acts of consummation which the Commission obtained was not effective to preserve an unembarrassed application of the federal "fair and equitable" standard in Section 11(e).

The Securities and Exchange Commission deemed it doubtful whether the plan ever became effective as a matter of state law, citing the holding of the Public Service Commission of the State of New York that it had not (R. 236). See *Re Long Island Lighting Co.*, 73 P.U.R. (N.S.) 266, 273 (1947) (R. 409, 420).[8] In any event this Commission held that it was "empowered and required to look beyond the naked issues arising under state law" (R. 238). It observed that the stockholders' vote was under duress resulting from an inequitable distribution of voting power, including the power to withhold dividends on the preferred stock (R. 237, n. 98), and that irrespective of the consequences which the state law may attach to the filing of the certificate in the office of the Secretary of State, the federal action taken to prevent the distribution of new securities precluded the interposition of innocent purchasers for value who might otherwise have traded on the basis of the

[8] The state commission has indicated that the 1944 plan was not effective because the new stock was not issued and the various accounting entries which had been required were not made (R. 417, 420).

plan being an accomplished fact. Both courts below agreed that, in determining a fair and equitable allocation as between Long Island's preferred and common stockholders, the Commission was free to disregard both the formal action taken by the company after the commencement of the proceedings before this Commission and the reluctant consent given by the New York Commission (R. 394, 867). This holding is clearly in accord with the decisions which recognize that federal law, as embodied in the "fair and equitable" standard of Section 11(e) of the Act, is paramount in this field and that under well-established equitable principles, the Commission was required to look behind the formal status of claims to the ultimate equities of the case. See *Otis & Co.* v. *SEC,* 323 U. S. 624, 635-638; *SEC* v. *Central-Illinois Securities Corp.,* 338 U. S. 96, 134; *Schwabacher* v. *United States,* 334 U. S. 182, 198; *Pepper* v. *Litton,* 308 U. S. 295, 302-306, 310; *Taylor* v. *Standard Gas & Electric Co.,* 306 U. S. 307.

There is no novelty in the instant case, nor any "clash of Federal and State jurisdiction, of wide scope and general importance" (Committee Petition 18). Actually, the New York Commission went further than the Securities and Exchange Commission both in denying effectiveness to the 1944 recapitalization even as a matter of state law, and in indicating that it regards any participation for the common stock of Long Island as unduly generous (R. 417, 420, 612, 653).

3. Petitioners raise several points addressed to the sufficiency of the record to support the Commission's findings of reasonably prospective earnings and the allocation of the new securities between the preferred and common stockholders of Long Island based upon such record.

(a) Petitioner Gordon argues that the Commission erred in not giving proper effect to "uncontradicted evidence of phenomenal and continuing growth in the territory served by the Long Island System"; and that the data which he had proffered, after the closing of the administrative hearings, with respect to possible construction financing and savings in production costs due to the advent of natural gas would show a far larger net income for the present stock investment than the Commission had forecast (Gordon Petition 7-9, 32-37). There is no substance to these arguments. The future growth of Long Island as well as the advent of natural gas were basic facts in this case, and the record conclusively shows that these factors were fully considered and explored by the Commission (R. 172-173, 201-209). As the Court below said: "The Commission took much evidence on the subject of natural gas and went so far as to reject the testimony of one expert who did not give weight to that factor. Likewise, it received evidence — of a rather speculative nature — on the future of the Long Island area" (R. 865). Moreover, since the Commission's estimates of prospective earnings from gas operations gave full effect to the ability of the gas properties to earn

a rate of return substantially in excess of past experience but deemed reasonable in the light of rate regulation in New York, any increased savings in expenses beyond those which were forecast by the witnesses may well be required to be passed on to consumers and would not be made available to investors.[9]

Nor is it true that the expansion of the system would necessarily increase the net income applicable to the present common stock. Such increments in earnings as petitioner suggests to be susceptible of mathematical demonstration depend upon uncertain long-range conjectures as to the extent of such growth and the type and cost of financing. Furthermore, as the court below indicated, it does not follow, "that increased future earnings would inure entirely, or at all, to the holders of present common stock . . . Thus, if future financing takes the form of stock flotation, as seems probable, there is no great likelihood that the present common's equity will be increased. If, on the other hand, the system's debt structure is enlarged, common's equity will be increased but so will its risk position." In a word, the possibilities upon which petitioner based his

[9] The Commission checked its earnings forecast against a computation showing that such earnings would be 6% on the indicated electric rate base and 5.8% on the indicated gas rate base, the differential reflecting an allowance for the time lag before natural gas was available (R. 207-209, 889). The New York Commission has not in recent years allowed more than a 6% return and in some cases has set rates of return at 5.5% (R. 206, n. 63).

estimates of an increased return for the common stock, as the court concluded, "are too remote and speculative to require consideration in terms of the present value of the common stock" (R. 864-865).

(b) Equally without merit is the contention that the proceedings should be remanded because the actual earnings for 1949 have exceeded the Commission's estimate (Committee Petition pp. 18-19). It is obvious that earnings predictions are not mathematically certain and in any one year earnings in fact may be greater than anticipated. For purpose of testing the fairness of the plan it is sufficient that on the average the earnings of the company will approximate the amount predicted. The mere fact that the earnings for the current year were above that amount is clearly of no moment. See *Group of Institutional Investors* v. *Chicago, M., St. P. & P. R. Co.*, 318 U.S. 523, 542-544. What the argument amounts to is that on the basis of one year's actual income the Commission was required as a matter of law to reopen the administrative proceeding.[10]

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[10] Illustrative of the wide fluctuations in the corporate net income of Long Island is the fact that over the ten-year period 1939 to 1948, inclusive, net income has ranged from a low of $1,425,419 to a high of $2,509,697 (R. 301).

In connection with a comparison of a spot year's net income with a forecast of reasonably foreseeable net income, as the court below noted, while the actual consolidated net income for the year 1949 was $77,279 more than the $3,500,000 estimate of prospective yearly net income, the actual net income for the year ended February 28, 1950, was $51,146 less than the estimate (R. 863).

(c) The committee complains that it was error for the Commission to refuse to reopen the record to receive further testimony with respect to an accounting entry of $10,263,969 (Committee Petition pp. 23-24). This amount reflects the deficiency in the depreciation reserve of the three companies being consolidated under the plan, as found by the New York Commission; and under the plan Long Island and its two subsidiaries originally proposed to increase the depreciation reserve by that amount. However, at the oral argument before this Commission, after the record was closed, the companies stated that they no longer proposed to make the adjustment in their depreciation reserve but instead proposed to set aside a portion of their unearned surplus in a separate account entitled "unearned surplus — special" for that amount, which would be available for transfer to the reserve for depreciation and for other charges (R. 174-175). The indicated modifications in the proposed accounting treatment by the company, which were themselves necessarily tentative and subject to the ultimate ruling of the New York Commission, did not present a significant new development, since it is the practice of the New York Commission to determine the appropriate rate of return regardless of what the balance sheet treatment of the depreciation reserve might be.[11] While the Commission checked its earnings forecast against currently

[11] See *Consolidated Edison Co.* v. *Maltbie*, 300 N. Y. 196, 90 N.E. 2d 35 (1949), appeal dismissed, 339 U. S. 973.

available indications concerning the maximum amount which the New York Commission would permit the company to earn, it obviously was not determining what the ultimate allowable rate might be under local law. Further testimony was, therefore, not required (R. 289-290), and the court below affirmed the Commission's view on that question (R. 867-868).

Whether or not to reopen the record in view of alleged changes in circumstances is a matter which rests largely in the discretion of the administrative agency and is rarely disturbed on review. *Interstate Commerce Commission* v. *Jersey City*, 322 U.S. 503, 514-518; *Group of Institutional Investors* v. *Chicago, M., St. P. & P. R. Co.*, 318 U.S. 523, 542-544; *Ecker* v. *Western Pacific R. Corp.*, 318 U.S. 448, 506-509. This is particularly the case where, as here, "the changes are of the kind that were envisaged and considered by the Commission in its deliberations upon or explanations of the plan." *Reconstruction Finance Corporation* v. *Denver & R. G. W. R. Co.*, 328 U.S. 495, 522. See also *Insurance Group Committee* v. *Denver & R. G. W. R. Co.*, 329 U.S. 607.[12]

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[12] Petitioner in No. 221 refers to an amendment to the railroad reorganization statute as indicating a Congressional policy requiring reopening of the record to take into account changed circumstances (Gordon Petition 12-13). It is not argued that the statute cited is specifically applicable to Holding Company Act reorganizations, and the discussion above demonstrates that, even if it be assumed that the policy of that statute is applicable, the Commission's action is consistent with that policy since no significant developments, not considered by the Commission, have taken place.

(d) Both petitioners urge that in determining that the foreseeable future earnings of the Consolidated Corporation were $3,500,000, the Commission had improperly failed to give effect to $250,000 in savings in operating expenses which were anticipated to result from the consolidation. (Gordon Petition pp. 13-14; Committee Petition pp. 19-21). These contentions are not supported by the record. The Commission's opinion followed the technique approved in *Otis & Co.* v. *SEC,* 323 U.S. 624, namely, a comparison of the interests of the preferred and common stockholders of Long Island as continuing interests, as if there were no reorganization, with the interests accorded them under the plan. Under this approach, the estimated consolidation savings were not directly used by the Commission in determining the relative investment values of the old stocks being surrendered, but, as the Commission's supplemental opinion notes, were considered, in appraising the return on the new securities, to be at best an intangible factor relevant to the risk that in a poor year earnings on the new stock might not equal the Commission's forecast (R. 890-891). Nor, as the Commission and the court below noted, was it clear how far, if at all, the New York Commission would allow the new company to profit by such savings (R. 889-890, 937). Although the Commission recognized that there might be circumstances under which it would be appropriate to utilize savings realizable only through reorganization as a direct measure of the

relative interests of the preferred and common stockholders, the supplemental opinion supplied an adequate explanation, which the court below accepted, of the Commission's determination that, in the circumstances of this case, such savings were not likely to result in net earnings to stockholders in excess of its forecast, and for not departing in the instant case from the technique theretofore followed with approval (R. 887-891, 937-938).

Petitioners contend that the procedure sanctioned by the court for finally disposing of the issue deprived them of a right to a hearing before the Commission and therefore denied them due process of law. We submit that due process requirements should not be interpreted as requiring a hearing to aid the Commission in elaborating its reasons for disposing of an issue upon which a record already had been made and which the Commission had previously considered after full opportunity for hearing.[13] As the court observed, for the limited purpose for which the matter was remanded a new hearing was not required, "any more than a new hearing would be required before a district judge if we asked the judge to say what findings of fact he had acted on but had not expressed in his opinion" (R. 937). See *Old Colony Bondholders* v. *N. Y., N. H. and H. R. Co.*, 161

[13] The Commission's first opinion mentions estimated consolidation savings four times, indicating that the Commission did not ignore that item and that the record contained the requisite factual data with respect thereto (R. 203, 204, 210, 212, 885-886).

F. 2d 413, 417-419 (C.A. 2), certiorari denied, 331 U. S. 858; *cf. Federal Communications Commission* v. *WJR,* 337 U. S. 265. Since petitioners had been given an opportunity to convince the court that "the Commission did not use the item at all . . . or that the use they did make of it was not permissible" (R. 938), the essentials of due process were amply satisfied.[14]

(e) Petitioner Gordon argues that in determining the allocation of the new common stock of the Consolidated Corporation between the preferred and common stockholders of Long Island, the Commission erred in employing the amount of $2,815,000 as the foreseeable net income of Long Island. Apart from the item of "consolidation savings" discussed above, he contends that the correct figure as a matter of law is $2,929,500 (Gordon Petition 17-18). This contention was not raised either before the Commission (R. 766-775), or in his objections filed in the District Court (R. 358-382), or in his statement of points on appeal (R. 845-847). In any event, we believe the point to be without merit.

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[14] Petitioner Gordon contends that the procedure was contrary to the notice requirements of Section 5 of the Administrative Procedure Act, 60 Stat. 238, 5 U.S.C. 1004. Aside from lack of merit for reasons noted in the text, it may be observed that the proceedings with respect to Long Island were commenced in 1945. Section 12 of the Administrative Procedure Act, 60 Stat. 244, 5 U.S.C. 1011, provides that the procedure requirements thereunder are not mandatory in any proceeding initiated prior to the effective date of the Act, which was December 11, 1946.

The Commission found that were Long Island to continue in existence as a separate entity not subject to reorganization, reasonably foreseeable earnings would be $2,815,000, and that on the basis of this forecast it would take approximately 14 1/2 years to pay off the arrears on Long Island's preferred stock (R. 233). It also found that the reasonably foreseeable net income of Queens was $450,000 and that of Nassau $235,000 (R. 209), or an aggregate of $3,500,000 for the Consolidated Corporation, to which Long Island was contributing 80.43%. The Commission stated: "The foregoing relative contributions of net income must, of course, be weighted by qualitative considerations which reflect, among other things, the risk factor inherent therein" (R. 226).[15] The Commission con-

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[15] Some of the analytical factors found by the Commission to reflect the superior quality of the foreseeable net income of Long Island as compared with that of the Consolidated Corporation, and which required compensation in the form of increased amount of net income to be received by Long Island over that surrendered by Long Island, are summarized below:

	Long Island	*Consolidated Corp.*
Ratio of long-term debt to total capitalization and surplus (R. 227)	64.4%	66.6%
Number of times fixed charges are earned on basis of estimates of reasonably foreseeable net income (R. 227)	2.38 times	2.22 times
Proportion of total revenues derived from electric operations (R. 195, 227)	73%	65%

cluded that the superior quality of Long Island's net income required that Long Island be allotted 83.7% of the new common stock, the foreseeable earnings on which are $2,929,500 (R. 226-228). In substance, the Commission found the $2,929,500 portion of foreseeable net income of the Consolidated Corporation to be the equitable equivalent, in terms of investment value, of the $2,815,000 prospective net income of Long Island apart from reorganization, in view of the differences in the risk factors previously noted. This finding is not disputed. Long Island's common stockholders, along with the preferred, have thus benefitted from the superior quality rating of Long Island's contribution to the consolidation, thereby reflecting both "the expectation of income from the new stock and the risk factor of that stock in relation to the rights being surrendered," *SEC* v. *Central Illinois Securities Corp.*, 338 U.S. 96, 144. Petitioner would have the Commission count this factor twice and indulge in the fiction that the proportion of earnings from the combined properties allocable to Long Island, admittedly of an inferior quality, should determine also the number of years in which it would be necessary, apart from reorganization, to pay off the arrears on the preferred stock being surrendered, and as a result further increase the participation of Long Island's common stockholders in the new stock of the Consolidated Corporation. Petitioner cannot have it both ways.

4. Petitioners in Nos. 220 and 249 argue that the Commission acted arbitrarily and in excess of its statutory authority in refusing to authorize the Protective Committee to solicit contributions to meet its expenses. They have raised this point in two ways. First, they petitioned the United States Court of Appeals for the District of Columbia Circuit to review the specific order of the Commission denying the committee authority to make the solicitation. It is to the order affirming the Commission that petition No. 249 is addressed. Second, they attacked the final order of the Commission, approving the plan, in the New York District Court and on appeal to the Second Circuit, on the ground that the committee was not afforded a fair hearing since it was not permitted to solicit funds. One of the grounds set forth in No. 220 is the finding of the Second Circuit, affirming the District Court, that the presentation of the common stockholders' case had not been prejudiced. It may be noted that if certiorari is denied in Nos. 220 and 221, or if this Court affirms the Second Circuit in those cases, the decision on the issue presented by No. 249 is of little, if any, significance to the interests of the stockholders, since in that event the plan would be consummated and the committee and its counsel would have no further opportunity for activity in the proceeding except to apply for allowances.

Consideration of this point can be conveniently divided into three steps: (a) Does the Public Utility Act authorize the Commission to pass on such

solicitations? (b) Assuming authority to pass on the question, was the Commission's order refusing permission to solicit proper? and (c) Whether or not the Commissions' action was authorized and proper, did any error which occurred invalidate the administrative proceedings on the reorganization plan?

(a) The Commission found its authority to pass upon the solicitation in Section 12(e) of the statute which expressly declares unlawful the solicitation of any "proxy, power of attorney, consent, or *authorization* regarding any security of a registered holding company * * * in contravention of such rules and regulations or orders as the Commission deems necessary or appropriate in the public interest or for the protection of investors or consumers or to prevent the circumvention of the provisions of this title or the rules, regulations, or orders thereunder." [Italics supplied] The Commission supported its order on the ground that this section should be interpreted to include the proposed solicitation of contributions from stockholders to meet the expenses of the committee.[16] In its findings the Commission stated, "Its [the Committee's] admitted purpose is to secure from holders of

[16] In an earlier case, the Second Circuit has upheld the Commission in its interpretation that the statute covered a preliminary letter to stockholders which did not ask for any specific power or authority but was designed as a first step in a program to obtain such representation. *SEC* v. *Okin*, 132 F. 2d 784 (C.A. 2).

common stock an advance of funds to be used to carry out the Committee's stated objectives to protect the rights attaching to such stock in the proceedings affecting Long Island. The solicitation of those funds is necessarily a solicitation of authority to use the funds in a representative capacity to carry out the stated objectives of security holder protection. The advancement of money to the Committee would amount to a more effective grant of authority to act with respect to the stock than any revocable formal authorization." (2 R. 102).

The Court of Appeals for the District of Columbia Circuit in affirming the Commission's interpretation of the statute referred to the preexisting abuses with respect to assessments and excessive fees which the Holding Company Act was intended to eliminate (2R. 110-111).[17] And this Court has recently referred to the evils and abuses of the use of deposit agreements in reorganization, a device closely related to the solicitation of contributions. See *Leiman* v. *Guttman*, 336 U.S. 1, 6-7.

In view of the avowed purposes of the solicitation and in the light of the objectives of the statute, it is submitted that the Commission was more than justified in holding that the proposed activity of the

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[17] See also *Special Committee to Investigate Receivership and Bankruptcy Proceedings*, S. Doc. No. 268, 74th Cong., 2d Sess. (1936), and *Report on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees*, prepared by the Securities and Exchange Commission pursuant to Section 211 of the Securities Exchange Act of 1934, Parts I-VIII (1937-1940).

petitioners was subject to the regulation of the Commission under Section 12(e) of the Act.[18]

(b) The Commission's refusal to permit the solicitation of contributions was amply supported in the present case. It was contemplated by the committee in its original approach to the stockholders, and reaffirmed in the proposed solicitation, that the committee would look primarily to the estate for reimbursement of its expenses including fees and expenses of its attorneys and its experts. (2R. 26, 44) Thus, there was before the Commission not a question of whether the committee or its counsel was entitled to allowances, but whether it was appropriate to obtain such funds in the meantime by soliciting contributions from the stockholders at large.[19] In passing upon the application, the Commission noted its duty to balance the preservation of beneficial class representation against the elimination of such abuses as are referred to above (2R. 103). It found that the abuses and complexities arising from soliciting funds from the security holders outweighed such advantages as there might be in financing committees through that method. Cf. *American Power & Light*

[18] It should be noted that the proposed letter which the committee wished to send to the stockholders included a specific request for a proxy in its statement, "We urge all holders of common stock, or certificates of deposit therefor, who have not heretofore done so, to execute and deliver their authorization to the Committee" (2 R. 45).

[19] The committee was free to seek financial support from a limited number of stockholders under Rule U-62 (b) which exempts a solicitation of not more than 25 persons.

Co. v. *SEC,* 329 U. S. 90, 112; *SEC* v. *Chenery Corp.,* 332 U. S. 194, 201-208.

In order to encourage effective participation by committees, the Commission has required management to provide them with stockholder lists, has granted them the right to participate actively in proceedings before it and has required that plans provide for allowances out of the estate of fees and expenses to committees and their counsel who have contributed to reorganization. (2R. 103). But, it has also been the Commission's usual procedure to provide for committee compensation only by considering requests for allowances when the proceedings have been concluded, at which time the contributions of all the representatives of security holders can be evaluated in the light of the results they have achieved.[20] The object of this policy is to prevent the manifold abuses and complexities resulting from permitting the stockholders to become financially involved with their committees before a determination has been made as to whether such committees are entitled to any compensation and, if so, how much. That this policy has not prevented active committee participation in holding company reorganizations is attested by the fact that the Commission had, on June 30, 1949, approved about 85 plans of reorganization under Section 11(e) in which 60 committees had been permitted to solicit authorizations. No committee, in

[20] This is in accord with the practice in bankruptcy reorganizations. See *In re Keystone Realty Holding Co.,* 117 F. 2d 1003, 1006 (C.A. 3).

Section 11(e) proceedings, aside from the committee in the present case, found it necessary to apply to the Commission for authority to solicit funds from the stockholders.

The Commission found that the instant committee had presented no facts justifying a departure from its usual procedure (2R. 105). We submit that the petitioners present no sufficient argument why the findings of the courts below sustaining the Commission should be reviewed here.

(c) Finally, we come to the question of whether, assuming the Commission was in error in refusing to permit the solicitation of funds, such error invalidates the Commission's final order on the reorganization plan. This issue is raised only in No. 220 since the Commission's action in approving the plan was not before the Court of Appeals for the District of Columbia Circuit in No. 249.

The request for permission to solicit was not filed with the Commission until the administrative record had been virtually completed. Thus, the presentation of any substantial additional evidence before the Commission was at least improbable and the refusal to permit the solicitation in no way impaired the effectiveness of the Committee in presenting its case to the Commission.[21] As to the subsequent steps in the proceeding, before the Commission and the courts, the records in these cases make it abundantly clear that the committee

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[21] The proponents of the plan had completed their case and the committee's witness had completed his testimony on direct and cross-examination. Counsel for the committee had stated, "We have only a few redirect questions" (R. 689-690).

has continued to have active legal representation.

We are content to rest upon the findings below. The Court of Appeals for the Second Circuit stated, "As to this Judge Kennedy found nothing in the record to show that the Committee's representation of the common stock 'was stifled, or was in any way weakened by the Commission's action' * * * The claim of prejudice from the Commission's refusal to permit solicitation of funds is not substantiated" (R. 863).

CONCLUSION

The decisions below are correct. There is no conflict nor any need for further review. Accordingly, the petitions for writs of certiorari should be denied.

PHILIP B. PERLMAN,
Solicitor General.
JOHN F. DAVIS,
Special Assistant to the Attorney General.

ROGER S. FOSTER,
General Counsel,
HARRY G. SLATER,
Chief Counsel, Division of Public Utilities,

AARON LEVY,
SOLOMON FREEDMAN,
ELLWOOD L. ENGLANDER,
Attorneys,
Securities and Exchange Commission.

August 1950

APPENDIX

Pertinent Statutory Provisions

The Public Utility Holding Company Act of 1935, 49 Stat. 803, 15 U. S. C. 79 *et seq.*, provides in pertinent part as follows:

> SEC. 3. (a) The Commission, by rules and regulations upon its own motion, or by order upon application, shall exempt any holding company, and every subsidiary company thereof as such, from any provision or provisions of this title, unless and except insofar as it finds the exemption detrimental to the public interest or the interest of investors or consumers, if—
>
> (1) such holding company, and every subsidiary company thereof which is a public-utility company from which such holding company derives, directly or indirectly, any material part of its income, are predominantly intrastate in character and carry on their business substantially in a single State in which such holding company and every such subsidiary company thereof are organized;
>
> * * * *
>
> (c) Within a reasonable time after the receipt of an application for exemption under subsection (a) or (b), the Commission shall enter an order granting, or, after notice and opportunity for hearing, denying or otherwise disposing of such application. The filing of an application in good faith under subsection (a) by a person other than a registered

holding company shall exempt the applicant from any obligation, duty, or liability imposed in this title upon the applicant as a holding company until the Commission has acted upon such application. The filing of an application in good faith under subsection (b) shall exempt the applicant from any obligation, duty, or liability imposed in this title upon the applicant as a subsidiary company until the Commission has acted upon such application. Whenever the Commission, on its own motion, or upon application by the holding company or any subsidiary company thereof exempted by any order issued under subsection (a), or by the subsidiary company exempted by any order issued under subsection (b), finds that the circumstances which gave rise to the issuance of such order no longer exist, the Commission shall by order revoke such order.

* * * *

SEC. 11. * * *

(e) In accordance with such rules and regulations or order as the Commission may deem necessary or appropriate in the public interest or for the protection of investors or consumers, any registered holding company or any subsidiary company of a registered holding company may, at any time after January 1, 1936, submit a plan to the Commission for the divestment of control, securities, or other assets, or for other action by such company or any subsidiary company thereof for the purpose of enabling such company or any sub-

sidiary company thereof to comply with the provisions of subsection (b). If, after notice and opportunity for hearing, the Commission shall find such plan, as submitted or as modified, necessary to effectuate the provisions of subsection (b) and fair and equitable to the persons affected by such plan, the Commission shall make an order approving such plan; and the Commission, at the request of the company, may apply to a court, in accordance with the provisions of subsection (f) of section 18, to enforce and carry out the terms and provisions of such plan. If, upon any such application, the court, after notice and opportunity for hearing, shall approve such plan as fair and equitable and as appropriate to effectuate the provisions of section 11, the court as a court of equity may, to such extent as it deems necessary for the purpose of carrying out the terms and provisions of such plan, take exclusive jurisdiction and possession of the company or companies and the assets thereof, wherever located; and the court shall have jurisdiction to appoint a trustee, and the court may constitute and appoint the Commission as sole trustee, to hold or administer, under the direction of the court and in accordance with the plan theretofore approved by the court and the Commission, the assets so possessed.

* * * *

SEC. 12. * * *

(e) It shall be unlawful for any person to solicit or to permit the use of his or its name

to solicit, by use of the mails or any means or instrumentality of interstate commerce, or otherwise, any proxy, power of attorney, consent, or authorization regarding any security of a registered holding company or a subsidiary company thereof in contravention of such rules and regulations or orders as the Commission deems necessary or appropriate in the public interest or for the protection of investors or consumers or to prevent the circumvention of the provisions of this title or the rules, regulations, or orders thereunder.

* * * *

SEC. 24. (a) Any person or party aggrieved by an order issued by the Commission under this title may obtain a review of such order in the circuit court of appeals of the United States within any circuit wherein such person resides or has his principal place of business, or in the United States Court of Appeals for the District of Columbia, by filing in such court, within sixty days after the entry of such order, a written petition praying that the order of the Commission be modified or set aside in whole or in part. * * *

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AUG 24 1950
CHARLES ELMORE CROPLEY
CLERK

IN THE

Supreme Court of the United States

OCTOBER TERM, 1950

Nos. 220 AND 221

IN THE MATTERS

OF

LONG ISLAND LIGHTING COMPANY,
QUEENS BOROUGH GAS AND ELECTRIC COMPANY,
NASSAU & SUFFOLK LIGHTING COMPANY,

COMMON STOCKHOLDERS COMMITTEE OF
LONG ISLAND LIGHTING COMPANY,

Petitioners,

AGAINST

SECURITIES AND EXCHANGE COMMISSION,
LONG ISLAND LIGHTING COMPANY,
QUEENS BOROUGH GAS AND ELECTRIC COMPANY,
NASSAU & SUFFOLK LIGHTING COMPANY,

Respondents,

AND

LOUIS W. GORDON, COMMON STOCKHOLDER OF
LONG ISLAND LIGHTING COMPANY,

Petitioner,

AGAINST

SECURITIES AND EXCHANGE COMMISSION, LONG ISLAND LIGHTING COMPANY, QUEENS BOROUGH GAS AND ELECTRIC COMPANY, NASSAU & SUFFOLK LIGHTING COMPANY,

Appellees-Respondents.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

BRIEF FOR RESPONDENTS, LONG ISLAND LIGHTING COMPANY, QUEENS BOROUGH GAS AND ELECTRIC COMPANY AND NASSAU & SUFFOLK LIGHTING COMPANY, IN OPPOSITION.

CHARLES G. BLAKESLEE,
Special Counsel for
LONG ISLAND LIGHTING COMPANY
QUEENS BOROUGH GAS AND ELECTRIC COMPANY
NASSAU & SUFFOLK LIGHTING COMPANY

DAVID K. KADANE,
CHARLES E. ELBERT,
Of Counsel.

APPEAL PRINTING CO., INC., 120 CEDAR STREET, NEW YORK, N. Y. COrtlandt 7-2321

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Opinions Below

The opinion of the District Court dated February 10, 1950, is printed in this Record at pages 363-398. (*In re Long Island Lighting Co.*, 89 F. Supp. 513, 1950). The opinions of the Court of Appeals for the Second Circuit dated June 1, 1950 and July 5, 1950 (both unreported) are attached to the printed Record as an addition (Record, pp. 860, 936).

The opinion of the Securities and Exchange Commission dated November 2, 1949 is printed in the Record at pages 145 to 346. The three opinions of the New York Public Service Commission, dated respectively September 24, 1947, June 16, 1948 and January 23, 1950, are printed in the Record at pages 409 to 682.

Jurisdiction

The jurisdiction of this Court is invoked under Section 1254 of the Judicial Code made applicable by Section 25 of the Public Utility Holding Company Act of 1935.

Statutes Involved

Public Utility Holding Company Act of 1935, 49 Stat. 803, (15 U.S.C.A. Sect. 79(a) *et seq.*)

Statement

We accept and adopt the statement of facts of the Securities and Exchange Commission contained in its brief submitted in this proceeding in opposition to the petitions for writ of certiorari.

Argument

The companies which are the subject of this reorganization, Long Island Lighting Company, Queens Borough Gas

and Electric Company and Nassau & Suffolk Lighting Company, hereinafter referred to as the Long Island Lighting System, adopt the views and arguments of the Securities and Exchange Commission expressed in its brief in opposition to the petitions for a writ of certiorari. This separate brief is submitted in opposition to the granting of a writ in order to bring to the Court's attention the serious financial problems of the System companies occasioned by the long and, in part, undue delay, in consummating the reorganization and consolidation which two qualified administrative agencies have, after a detailed examination, found necessary in the public interest.

The Long Island Lighting System has been beset with financial problems for fifteen years. Preferred stock dividends have not been paid since 1937, and dividend arrears on the $35,000,000 of preferred stocks of the System now total more than $25,000,000. This has prevented the Companies in the System from selling equity securities to finance their post-war expansion, as neither preferred nor common stocks may be sold under those circumstances.

Since 1945 the solution of these problems has been sought under the Public Utility Holding Company Act of 1935. After revocation by the Securities and Exchange Commission of the System's exemption, a Registration Statement was filed. The Commission subsequently held that the structure of the Long Island System violates Section 11(b)(2) of the Act (R. 141) and that the consolidation which the Companies wish to consummate is necessary to effectuate compliance with the Act (R. 120).

Since the filing of the Consolidation Plan in October 1945, thirty-six hearings have been held before the S. E. C. on that Plan and its two modifications (the second of which was approved by the Commission and is the Plan involved in these proceedings). The record before the

S. E. C. consists of 4,318 pages of testimony and more than 400 exhibits, exploring in full detail the past and future of the Long Island Lighting System. The same Plan was approved by the Public Service Commission of the State of New York, except with respect to the allocation of shares of common stock to the old common stockholders of Long Island. The Public Service Comission held that the old common stock of Long Island should receive no participation whatever, but it deferred in this regard to the S. E. C. as having paramount jurisdiction. (R. 674) The Record before the Public Service Commission, which held hearings on nineteen days, consists of 2,028 pages of testimony and 140 exhibits.

In brief, the proceedings have been pending for five years, and exhaustive hearings have been held before the two administrative bodies. As a result of this delay, it has become urgent that the System be placed in a position to sell equity securities in order to finance its needed capital additions. Both the federal and state Commissions have criticized the present capital structure as being top-heavy with debt. See *Long Island Lighting Co.*, Holding Company Act Rel. No. 9137, June 6, 1949; R. 654, 655. The urgency has become acute in view of the foreign situation and the unsettled security markets occasioned thereby. Further delay in consummating the Consolidation Plan can have serious adverse effects not only on the investors in the System's securities but also on the consumers in the territory served by the three System companies.

At best the interest of the common stock of Long Island is marginal. For this reason, the representatives of the common stockholders have had little interest in the securing a prompt reorganization, and the common stockholders have been nourished by the the hope that "something may turn up." This explains the curious timing of the pro-

ceedings both before the Commission and before the Courts with respect to the effort of the Common Stockholders' Committee to obtain contributions from the individual stockholders prior to a S. E. C. allowance of fees.

The System companies had no interest in the proposal of the Common Stockholders' Committee that it be permitted to solicit funds from the stockholders it represented, and therefore, did not seek to become parties to the appeal of the Committee from the determination of the S. E. C. denying the Committee the right to obtain advance fees. However, the System companies are deeply concerned when the legal proceedings connected with the solicitation project are sought to be injected here for some strategic purpose best known to the Committee but having all the appearance of tactics designed to delay further the consummation of the Plan of Consolidation.

The Committee has not seriously pursued this solicitation project on the merits, but has maneuvered that the matter be brought before this Court at the same time as the petition for a writ in the reorganization proceedings. The Committee was organized in May 1948. It promptly moved (May 21, 1948) for permission to solicit authorizations. Immediately thereafter Committee counsel appeared at hearings and took an active part in the proceedings before the S. E. C. However, it was not until October 28, 1948, *at a time when the record in the proceedings was virtually closed,* that the Committee applied for permission to solicit five cents a share from the stockholders it represented, and used the pendency of that application as a lever to delay the closing of the Record in the reorganization case. (R. 690-694, 699.) Although the Committee's application for the solicitation of funds was originally filed in September of 1948, no request was made at the conclusion of the cross-examination of the Committee's

expert witness that the Committee's direct case in the reorganization proceeding be held up until the Commission had acted on the solicitation proposal. (R. 689.) The latter request was first made—and denied—on January 5, 1949 when the Plan proceedings, which had begun in 1945, were virtually concluded. A hearing was held on the solicitation application on November 12, 1948. At the conclusion of the hearings proposed findings and briefs were submitted and oral argument was heard by the full Commission on January 5, 1949. On March 31, 1949 the Commission issued its Findings, Opinion and Order denying the permission sought. If this Committee had shown ordinary diligence it could have filed a petition for review to the Court of Appeals for the District of Columbia early in April. The proceeding was simple and required no undue amount of labor to prepare. It chose, however, to delay and the petition was not filed until May 28, 1949, on the fifty-eighth of the permissible sixty day period. Because of delays in the filing of briefs the matter was not argued before the Court of Appeals until January 10, 1950. The decision of the Court of Appeals affirming the S. E. C. determination was rendered April 24, 1950. Instead of applying in good time to the Court of Appeals for a rehearing, or promptly seeking a writ of certiorari in this Court, the Committee on May 9, 1950 moved the Court of Appeals for an order to extend its time to, and including June 8, 1950, to ask for rehearing and to await the decision of the Second Circuit. This motion was opposed by the S. E. C. and the Court properly denied it. Finally, on or about July 21, 1950, the Committee applied, *ex parte,* for an extension of time to file with this Court a petition for a writ of certiorari. The application was granted giving the Committee until August 22, 1950 to do so.

The timing is important. The petition for the writ of certiorari in the solicitation proceeding, with the ordinary diligence to be expected of a Committee if relief on the merits had been the objective, could have been disposed of before this Court had recessed for the summer. Certainly, the legal steps should have been pressed if the collection to be made among the common stockholders was to serve the purpose avowed, *i. e.,* to aid the Commmittee in making a proper and full presentation of the stockholders' case before the Commission and the Courts. Instead, the proceeding has been conveniently carried over so that it comes to this Court in ready juxtaposition to the petition on the reorganization proceeding.

It should also be mentioned in this connection that in the reorganization proceeding, in both the District Court and the Court of Appeals, the Committee asked for a stay until the determination by the Court of Appeals of the District of Columbia of the appeal in the solicitation case.

These are curious motions indeed for a Committee which is arguing that unlike other protective committees it must solicit contributions in order to make an effective presentation of its case in the consolidation proceedings. There are no facts to negative the suspicions, first, that the solicitation case has been used as a possible entering wedge to induce this Court to bring the consolidation proceedings before it, and second, that the solicitation case has been used as an instrument to delay consolidation in the hope that "something may turn up."

Nor is there any reason to believe that the other petitioner for certiorari, Louis W. Gordon, is in any hurry to bring about a prompt reorganization of the System. Gordon purchased all his shares (including 500 shares of preferred stock) after the S. E. C. hearings were closed. It

is Gordon who now complains that the record before the S. E. C. was inadequate, even though the record was made before he became a stockholder.

The fundamental issue in the case is the soundness of the S. E. C.'s forecast of earnings. All other considerations aside, if S. E. C.'s judgment as to the earnings potential of the various classes of stock in the Long Island System is sound, the Plan is fair. We submit that the earnings forecast of $3,500,000 as of March 31, 1949, which the Commission determined in November of 1949, was reasonable; and that subsequent developments have not created any legitimate doubt as to the soundness of the Commission's method. It is true that net income for the twelve months ended June 30, 1950 was $3,687,000, which is slightly higher than the Commission's figure; it is also true, however, that *all* earnings subsequent to March 31, 1949 have been reinvested in the Company's properties, and as a result accrued preferred dividends have further increased.

It should also be mentioned that at the time of the Commission's earnings forecast, the System's earnings had never been as high as the $3,500,000 figure used by the Commission; that since the beginning of the Korean embroilment a new inflationary cycle appears to have commenced (and inflation historically has always been a severe depressant of public utility earnings); that the President of the United States has proposed increased corporate income taxes which would cost the Long Island System more than $400,000 a year; and that an excess profits tax similar to the tax in the second world war, whether computed on the basis of average earnings for some past period, or on the basis of an allowance of 5% on stock

capital and 2½% on borrowed money, would have a severely detrimental effect on the System's earnings.

We urge (1) that there is a substantial public interest in prompt consummation of the reorganization, so that necessary equity securities can be sold; (2) that as a practical matter, viewed in the light of the international developments of the past three months and their possible repercussion on the country's economic and tax structures, the earnings forecast used by the S. E. C. may be regarded today as generous to the common stockholders; and (3) therefore that unless some grievous error was committed below, the petitions for certiorari should be denied.

Respectfully submitted,

CHARLES G. BLAKESLEE,
Special Counsel for
LONG ISLAND LIGHTING COMPANY
QUEENS BOROUGH GAS AND ELECTRIC COMPANY
NASSAU & SUFFOLK LIGHTING COMPANY

DAVID K. KADANE,
CHARLES E. ELBERT,
Of Counsel.